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SUBJECT: CHINA'S INCREASING COMMERCIAL TIES WITH VENEZUELA

REF: CARACAS 773

Classified By: ECONOMIC COUNSELOR RICHARD M. SANDERS FOR REASON 1.4 D

SUMMARY

¶1. (U) Venezuelan President Hugo Chavez has identified China as an alternative commercial partner to the "imperialistic" United States and has moved aggressively to cultivate Sino-Venezuelan relations. Recent state visits between the two countries have yielded dozens of agreements; however, most have been at the "memorandum of understanding" and "letter of intent" level. Chinese officials concede that, among Latin American countries, Venezuela's relative importance to China remains moderate, but the Chinese have demonstrated a desire to expand the bilateral commercial relationship. Bilateral commerce has been increasing rapidly, though from a fairly modest base. The Chinese continue to increase their investment in Venezuela, primarily in the energy sector through state-owned enterprises. Chinese companies are also active competitors to provide telecommunications equipment to Venezuelan companies and to Venezuela's new state-owed CVG Telecom and sellling oil field equipment to state petroleum enterprise PDVSA. Venezuela would like to sell oil to China, diversifying its markets away from the U.S. This however is easier said than done. China appears to view Venezuela in purely economic terms while politics seems to largely drive Chavez's approach to the relationship. END SUMMARY

The Road is Paved With Good Intentions

¶2. (U) Visiting China in December 2004, Chavez complimented China for being a big country without being imperialistic while criticizing U.S. "imperialism" and referring to American capitalism as "the road to hell." During this visit he also affirmed Venezuela's support for China's "one China" policy with respect to Taiwan. During the visit by Chinese Vice President Zeng Quinghong to Venezuela in February 2005, the governments of Venezuela and China signed 19 bilateral agreements on issues including the opening of 7 new oil fields to Chinese companies, a grant for $12 million to Venezuela for unspecified commercial purposes, a $42 million preferential credit facility to finance Chinese projects, memoranda of understanding (MOU) covering the oil industry, aluminum smelting, and an MOU to jointly develop satellites. As has been seen in other state visits that culminate with a lengthy signing ceremony, few if any binding contracts were signed.

¶3. (U) In April 2005, an additional series of letters of intent were signed with Chinese enterprise Lang Chao for a possible joint venture to produce software and computers; with Haier, China's largest home appliance manufacturer, for a potential factory in Venezuela, and Shandong Foton Heavy Industries for the possible local production of farming and construction equipment.

China-Venezuela Trade Small, But On The Rise

¶4. (C) According to Wan Jian, Commercial Counselor of the Chinese Embassy in Venezuela, China is working to increase the level of both trade with and investment in the country. Jian told econoff that the level of trade with Venezuela -- approximately $1.3 billion in 2004 -- ranks as only the seventh largest in Latin America behind Brazil, Argentina, Chile, Mexico, Peru and Panama. (Note: In comparison, Chinese trade with Venezuela is less than ten percent of that with Brazil and accounted for about one-tenth of one-percent of China's global trade in 2004. End Note.) On the investment side, according to Jian, Venezuela accounts for between 60-70 percent of China's regional investment and is concentrated primarily in the energy sector. China's energy investments have been made primarily through the China National Petroleum Company (CNPC) and a joint-venture with state-owned Bitumenes del Orinoco (BITOR) (see par. 11).

¶5. (C) Jian said that he expected the level of

China-Venezuelan trade to continue to accelerate, pointing to the near doubling of trade from 2003-2004. When asked what he felt about business conditions in Venezuela, he complained about the exchange control system and the inefficiencies and delays caused by Venezuela's foreign exchange control authority, CADIVI, in repatriating capital. He also pointed out that Chinese exporters were experiencing significant delays in payment. This, he said, was because payments could not be released until goods had been inspected in Venezuela rather than being paid F.O.B. in the Chinese port of origin. Jian also confirmed Chinese interest and involvement in supplying equipment in both the telecommunications and agricultural equipment sectors.

¶6. (C) Mimy Mock De Fung, President of the Chinese-Venezuelan Chamber of Commerce (CAVENCHI), told econoff that Chinese companies were increasingly looking at Venezuela as a source of raw materials and a market for Chinese finished goods. She commented however, that Chinese investment and trade decisions were made "on the basis of business calculations," and not for ideological reasons as appeared to be the case from the Venezuelan side. She pointed out that the vast majority of Chinese investment -- about two-thirds -- had been made by the Chinese state enterprises. She expected, however that the level of private investment would be increasing as a result of the trend towards closer Chinese-Venezuelan relations. (Note: During the visit, econoff observed construction underway as CAVENCHI was substantially expanding the size of its office. End Note.)

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Strong Competitors in Public Tenders
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¶7. (C) In a meeting with emboffs, Lucent Technologies Venezuela General Manager Raul Socorro said he believed U.S. companies were being unfairly disadvantaged in GOV procurement, and cited favoritism shown by the new state telecommunications enterprise, CVG Telecom, as an example (see par. 9). He also complained that Chinese firms were often able to include preferential financing -- supported by the GOC -- in order to win bids. While he felt that Lucent could still compete in Venezuela, based on superior technology and service, Socorro said that Lucent's profit margins and market share were being quickly eroded. (Note: In a public forum attended a member of Embassy's commercial section, Alvin Lezama, Director General of Conatel, Venezuela's national communications commission, told the Venezuelan companies in attendance that to be successful, bidders on government telecommunications projects should have non-US partners, preferably Chinese, Indian, or French. End Note.)

¶8. (C) Cisco Systems Country Manager Juan Carlos Lopez was more upbeat about the prospects for his country in the face of Chinese competition. Lopez agreed that the Chinese were fiercely competitive in the Venezuelan telecommunications market, were often able to offer excellent terms (including financing) and were favorably viewed by the GOV. However, he denied that Cisco was being specifically discriminated against as a U.S. company and speculated that Cisco's business model of working through local resellers mitigates the political pressure. Lopez also identified major corruption in the procurement process as a hindrance to doing business and implied that Chinese companies might be behaving in ways forbidden to U.S. companies by the Foreign Corrupt Practices Act.

¶9. (C) Frustrating the efforts of economic observers and would-be bidders is the fact that government tenders in Venezuela have become more and more opaque. Recently, CVG Telecom, a newly formed telecommunications company owned by the state-owned industrial giant, Corporacion Venezolana de Guayana (CVG), was reported to be contracting for $150-200 million worth of telecommunications equipment and service. CVG Telecom plans to use CVG's existing fiber-optic capabilities and rights of way along with new investments in mobile telephony to compete eventually with Venezuela's privately owned telecommunications providers. Venezuelan representatives of Lucent, which had been pursuing the contract, were told by CVG contacts that the Chinese firm Huawei Technologies had been selected for the contract. Following the ouster of CVG Telecom's President, Hipolido Izquierdo, Emboffs met with the company's new president,

Julio Duran, who informed them that the contract was still open and was unaware that Lucent was interested in the tender. It remains unclear how and when the contract will ultimately be awarded.

Petroleum Relations

¶10. (U) China, the second largest oil consumer in the world, has had a presence in the Venezuelan oil business since the late 1990's when the Chinese National Petroleum Company won two Operating Service Agreement contracts for the Caracoles and Intercampo Norte fields. The deals opening seven new oil fields to Chinese drillers announced in February are in addition to an operating agreement for 15 fields in eastern Venezuela that was announced during President Chavez's visit to China in late 2004. (Note: There is a rumor in the energy sector in Caracas that, in the flurry of agreements the GOV signed with countries such as China and India in 2004 and early 2005, the GOV actually signed agreements with two or more countries that cover substantially the same fields. End Note.) According to published reports, Chinese companies have agreed to invest $350 million in oil fields in Venezuela and $60 million in a natural gas venture.

¶11. (C) The China National Petroleum Corportion and Petrochina Fuel also formed a joint venture with Petroleos de Venezuela's BITOR affiliate in 2001 for the manufacture of Orimulsion, Venezuela's patented heavy oil/water blend developed to replace coal in power plants. Since the December 2002-February 2003 national strike, there has been an active debate in Venezuela on the value of Orimulsion, with the current Vice Minister of Energy Bernard Mommer arguing forcefully that the return on the heavy oil used in Orimulsion would be greater if it were blended with lighter oil and sold as crude. PDVSA has in fact announced that Orimulsion contracts with other nations such as Canada and Italy will not be renewed upon contract expiration. Despite this, the "Sinovensa" joint venture has moved ahead and has started construction of a 7.25 million metric ton per annum orimulsion manufacturing facility at the Jose Industrial complex near Puerto La Cruz.

¶12. (C) A U.S. company executive told econoffs visiting eastern Venezuela June 7-8 that PDVSA is taking extraordinary measures to support the continued export of Orimulsion to China despite its overall desire to withdraw from the business (leaving customers in Italy and Canada without a source of supply for power plants specificaly tooled up to take the fuel). According to this manager, PDVSA employees have informed members of his staff that as much as 20-25,000 barrels per day of PDVSA's own oil production is being lost because of the emphasis senior PDVSA management have put on carrying the orimulsion for China through a pipeline that is not big enough to carry both the Orimulsion and the production from all the fields in the area. The U.S. company manager expressed his increasing concern that his oil will be squeezed out of the PDVSA pipeline. (Comment: PDVSA seems to be making a big effort to supply the Chinese despite persistent reports in the energy sector in eastern Venezuela that the Chinese are actually running the cheap Orimulsion through a refinery and using the heavy oil for asphalt. End comment.)

¶13. (C) In their recent trip to eastern Venezuela, econoffs also met with a representative of a U.S. drilling company who stated that his firm has decided to leave Venezuela in the face of the competition from Chinese drilling companies. According to this executive, the presence of Chinese drilling companies is expanding rapidly, particularly in eastern Venezuela. The Chinese, he said, are under-bidding other companies on PDVSA contracts with "rigs made of metal scraps." The services they provide, he said, do not match those of other international service companies.

¶14. (C) Shipments of Venezuelan crude to China (as opposed to sales of Orimulsion and products such as fuel oil) reportedly began within the last year with periodic shipments of Boscan crude from western Venezuela. Public discussion of the idea of a pipeline through Colombia or Panama to carry Venezuelan crude to a Pacific port for shipment to China has also increased in the past year. The GOV has repeatedly claimed that crude shipments to China would come from increases in production rather than any reallocation of current supply commitments. This claim, however, runs contrary to reports that GOV is actively working through oil traders to divert shipments to non-US buyers in addition to systematically replacing supply contracts with US firms with contracts with firms from India and China as they expire. These moves are being pursued despite the substantial per barrel discount that Venezuela reportedly has to offer in order to offset increased transportation costs to ship oil to China rather than the U.S. (see reftel).

Military Relations - No Big Sales Yet

¶15. (C) Despite talk of closer military ties between China and Venezuela, there appears to be little evidence of progress in that direction. For the first time, the entire graduating class of Venezuela's war college, some 70

officers, were invited to a two-week orientation in China. In addition, there have been unconfirmed rumors that the Venezuelans have been pursuing the purchase of military radars from China, and the two countries have been discussing a Venezuelan purchase of a communications satellite, though it is not known if it would be for civilian or military purposes.

Comment

¶16. (C) As part of his campaign to create a "multi-polar world" to diminish U.S. power, Venezuelan President Hugo Chavez has been working to draw Venezuela closer to countries such as Brazil, Russia, China, and Iran which he sees as antipathetic to or in competition with U.S. interests. The level of bilateral trade and investment is low, but it does provide China with a destination for Chinese investment and a source of raw materials including oil and industrial metals, possibily at preferential prices. President Chavez for his part gets to claim another "ally" in his fight against the neo-liberal imperialism of the U.S. and can pursue his economically questionable policy of oil sales diversion away from the U.S. What distinguishes the China relationship from other Venezuelan bilateral relationships somewhat is the ideological rhetoric gushing from Caracas. President Chavez has gone out of his way to declare himself a Maoist, a 21st century socialist and has gone as far as to publicly claim that Venezuelan national hero Simon Bolivar and Mao Tse Tung would almost certainly have been friends, and that Bolivar would no doubt have been a socialist had he lived a few decades longer. From our perspective, the Venezuelans appear to be the primary boosters of the relationship, and sources tell us that the Chinese are happy to come along for the ride as long as the relationship makeQeconomic sense. For the time being, the relationship works -- primed both by convenience and a healthy dose of Venezuelan concessions.
Brownfield

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